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OFFICE OF INSPECTOR GENERAL
for the Millennium Challenge Corporation

**AUDIT OF THE MILLENNIUM
CHALLENGE CORPORATION'S
MANAGEMENT OF SECTION
609(g) FUNDS**

AUDIT REPORT NO. M-000-06-002-P
SEPTEMBER 28, 2006

WASHINGTON, DC



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*Office of Inspector General
for the
Millennium Challenge Corporation*

September 28, 2006

Mr. John Danilovich
Chief Executive Officer
Millennium Challenge Corporation
875 Fifteenth Street, N.W.
Washington, DC 20005

Dear Mr. Danilovich:

This letter transmits our final report on the Audit of the Millennium Challenge Corporation's Management of Section 609(g) Funds. In finalizing the report, we considered your written comments on our draft report and included those comments in their entirety in Appendix II of this report.

The report contains four audit recommendations for corrective action. Based on your response to our draft report, we consider that a management decision has been reached on each recommendation. Final action for the recommendations must be determined by the MCC, and we ask that we be notified of the MCC's actions.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Sincerely,

/s/
John M. Phee
Assistant Inspector General
Millennium Challenge Corporation

CONTENTS

Summary of Results	1
Background	2
Audit Objectives	3
Audit Findings	4
Did the Millennium Challenge Corporation Award Section 609(g) Assistance Funds in Accordance with Its Policy?	4
MCC Did Not Have a Section 609(g) Policy in Place When Awarding Assistance Funds to Several Section 609(g) Countries	4
Did the Millennium Challenge Corporation Track and Monitor Section 609(g) Funds to Ensure Funds Were Used for the Intended Purposes Under the Millennium Challenge Act of 2003?	5
MCC Needs to Improve Monitoring of Section 609(g) Cash Advances	6
MCC Needs a Formal Policy to Approve Section 609(g) Contractors' Invoices	8
MCC Needs to Improve Its Process for Approving and Documenting Exceptions to the Procurement Agreement	10
MCC Needs to Formally Develop Country Procurement Capacity Assessments Guidelines	11
MCC Needs to Improve Monitoring of Overseas Procurement Practices	13
Evaluation of Management Comments	15
Appendix I – Scope and Methodology	16
Appendix II – Management Comments	17
Appendix III – Flow Chart of 609(g) Process	20

SUMMARY OF RESULTS

The Assistant Inspector General for the Millennium Challenge Corporation (MCC) conducted this audit as part of its fiscal year 2006 audit plan to determine whether the Millennium Challenge Corporation awarded Section 609(g)¹ assistance funds in accordance with its policy and tracked and monitored Section 609(g) funds to ensure that the funds were used for the intended purposes under the Millennium Challenge Act of 2003 (page 3).

The audit concluded that the MCC awarded Section 609(g) assistance funds in accordance with both its June 2005, and revised October 2005 policies. However, prior to June 2005, the MCC did not have a policy in place when it awarded Section 609(g) funds to its initial five recipient countries (pages 4 - 6). The revised October 2005 policy strengthened MCC's awarding of Section 609(g) assistance funds in that: (1) financial management and procurement processes to control payments of the Section 609(g) funds were defined, (2) country ownership was clearly defined and (3) submitting a work plan with a timeline and estimated budget was required. Furthermore, the MCC held a training conference for eligible countries to inform and educate their representatives as to the requirements, roles and responsibilities under the Section 609(g) program. The MCC is also drafting an updated policy to address the issue of bridge funding² under the Section 609(g) program.

The audit also concluded that the MCC had developed initiatives to track and monitor Section 609(g) funds to ensure such funds were used for the purposes intended under the Millennium Challenge Act of 2003. For example, the MCC developed and implemented guidelines in assessing the fiscal capacity of eligible countries and streamlined its contracting acquisitions process.

However, the audit identified several opportunities for further improvements to the Section 609(g) program specifically, (1) the initial lack of documented Section 609(g) assistance or bridge funding policies and procedures (pages 4 -6); (2) inadequate monitoring and tracking of Section 609(g) funds, specifically in the areas of financial controls, country procurement capacity assessment guidelines; and (3) inadequate oversight of overseas procurement activities (pages 7-15).

In its response to our draft report, the MCC agreed with the recommendations and explained its plans for implementing them. Therefore, we consider that a management decision has been reached on each recommendation (pages 9, 11, 13, and 14). Management comments are included in their entirety in Appendix II (page 17).

¹ Section 609(g) of the Millennium Challenge Act of 2003 permits the Chief Executive Officer to enter into a contract or make grants for any eligible country for the purpose of facilitating the development and implementation of the compact between the United States and the country.

² Bridge funding assists countries with Administrative overhead costs after they sign their Compacts.

BACKGROUND

On January 23, 2004, the Millennium Challenge Corporation (MCC) was established by the Millennium Challenge Act of 2003 (Act) to administer the Millennium Challenge Account (MCA). The MCC is a government corporation designed to provide assistance to selected developing countries that rule justly, invest in their people, and encourage economic freedom. Since it was established, the MCC has as of March 2006, selected a total of 23 countries eligible to submit proposals for assistance and has signed Compacts³ with eight of them.

In addition to providing assistance to eligible countries through Compacts, the MCC, through the Authority of Section 609(g) of the Act,⁴ commits funds to eligible countries that need assistance to develop and implement Compact proposals. For example, Section 609(g) funds can be used for management support, monitoring and evaluation, and feasibility studies. The MCC contracts with U.S. and international firms to perform these functions. As of March 2006, the MCC had committed funds to 11 countries under the Section 609(g) program. Of these countries, seven had received funding for developing their Compacts; while the other four have received commitments from the MCC for funding after they sign their Compacts (i.e. bridge funding). The chart below illustrates the number of countries receiving Section 609(g) funding and the amount the MCC committed to each country.

Country	Date of Approval	Amount Committed	Type of Section 609(g) Funding
Armenia	3/28/2006	\$ 500,000	Bridge-funding
Benin	3/3/2006	\$ 1,536,490	Bridge-funding
Cape Verde	6/28/2005	\$ 255,000	Pre-Compact
Cape Verde	11/9/2005	\$ 70,000	Pre-Compact
Georgia	5/4/2005	\$ 4,155,000	Pre-Compact
Georgia	11/29/2005	\$ 606,600	Bridge-funding
Ghana	5/20/2005	\$ 57,000	Pre-Compact
Ghana	5/26/2005	\$ 227,000	Pre-Compact
Ghana	7/11/2005	\$ 3,000,000	Pre-Compact
Lesotho	5/17/2005	\$ 1,400,000	Pre-Compact
Madagascar	3/3/2005	\$ 1,000,000	Pre-Compact
Mali	1/23/2006	\$ 9,700,000	Pre-Compact
Mozambique	8/22/2005	\$ 6,000,000	Pre-Compact
Mozambique	5/17/2006	\$ 7,861,305	Pre-Compact
Nicaragua	4/20/2005	\$ 117,868	Pre-Compact
Nicaragua	2/6/2006	\$ 75,000	Bridge-funding
Senegal	6/30/2005	\$ 6,500,000	Pre-Compact
TOTAL		\$ 43,061,263	

³ A Compact outlines, among other things, program objectives, related projects, project funding and a program implementation framework.

⁴ Section 609(g) of the Act: "Notwithstanding subsection (a), the Chief Executive Officer may enter into contracts or make grants for any eligible country for the purpose of facilitating the development and implementation of the Compact between the United States and the Country".

To commit funding to these countries, and to adhere to Section 609(g) of the Act, the MCC developed Section 609(g) policies that addressed the criteria that it and the eligible countries should follow when requesting funding. The policy cites seven criteria each country should meet, including at a minimum: reflecting country ownership through a consultative process, documenting its commitment through the allocation of human and financial resources, and defining its financial management and procurement processes. In addition, the policy provides for post-Compact funding—bridge funding—which assists countries with administrative overhead costs after they sign their Compact. The flowchart in Appendix III provides an illustration of the MCC's 609(g) process.

Before the MCC commits funding to these countries, it conducts fiscal and procurement assessments of the countries' financial and procurement management capacity. If the MCC determines that the country does not have the capacity to manage the Section 609(g) funds or manage its procurement process, the MCC will serve as the fiscal and procurement agent. When this occurs, the MCC procures contractors to work on specific Section 609(g) projects and pays the contractors directly, without transferring any funds to the government's account. When the MCC determines, through its fiscal assessment, that a country is capable of serving as its own fiscal agent, it transfers the funds into the government's account in order to pay the contractors. If the MCC determines that the country could only manage its own procurement process, the country procures its contractors, but the MCC pays the contractors directly.

The audit fieldwork was conducted at the MCC Headquarters, with site visits to MCA - Georgia and MCA - Lesotho from April 5, 2006, to June 16, 2006. As of June 16, 2006, the MCC had committed a total of \$43,061,263 for Section 609(g) funding. In addition, as of April 7, 2006 it has disbursed a total of \$1,176,581 to the countries to whom it had committed Section 609(g) funding.

AUDIT OBJECTIVES

The Assistant Inspector General for the Millennium Challenge Corporation conducted this audit as part of its fiscal year 2006 audit plan. The objectives of this audit were to answer the following questions:

- Did the Millennium Challenge Corporation award Section 609(g) assistance funds in accordance with its policy?
- Did the Millennium Challenge Corporation track and monitor Section 609(g) funds to ensure such funds were used for the intended purposes under the Millennium Challenge Act of 2003?

Appendix I contains a discussion of the audit's scope and methodology.

AUDIT FINDINGS

Did the Millennium Challenge Corporation Award Section 609(g) Assistance Funds in Accordance with its Policy?

The audit concluded that the MCC awarded Section 609(g) assistance funds in accordance with both its June 2005, and revised October 2005 policies. However, prior to June 2005, the MCC did not have a policy in place when it awarded Section 609(g) funds to its initial five recipient countries.

The MCC complied with its revised October 2005 policy relating to awarding Section 609(g) assistance funds by ensuring that for example Mali, document that; (1) financial management and procurement processes to control payments of the Section 609(g) funds were defined, (2) country ownership was clearly established, and (3) the Government of Mali submitted a work plan with a timeline and estimated budget. Further, the MCC held training conferences for eligible countries to inform and educate their representatives as to the requirements, roles and responsibilities under the Section 609(g) program, and the MCC was also drafting a policy to address the issuance of bridge funding under the Section 609(g) program.

In spite of these changes, we noted that the MCC committed funds identified as Section 609(g) bridge funding to four countries without any documented policies to ensure consistent and adequate guidance.

These areas are discussed below.

MCC Did Not Have a Section 609(g) Bridge Funding Policy in Place When Awarding Assistance Funds to Several Section 609(g) Countries

Summary: The Millennium Challenge Corporation (MCC) committed bridge funding assistance to four countries without having a documented policy in place. This condition occurred because the MCC, as a new organization, was still in the process of developing specific policies and procedures. The absence of a formally developed policy created a potential for inconsistencies and nonstandardization in the process. A policy related to bridge funding is still being updated even though the MCC continues to commit this type of funding.

Section 609(g) of the Millennium Challenge Act of 2003 gives the MCC the authority to provide assistance to countries to develop and implement their Compacts. The MCC's current policy on Section 609(g) was developed and implemented in October of 2005. This policy lists seven conditions that should be present before the MCC will consider making Section 609(g) funds available to an eligible country.

The MCC did not have a policy in place to address the issue of Section 609(g) bridge funding assistance to four countries: — Armenia, Benin, Georgia and Nicaragua. For Armenia and Benin, two countries that had recently been committed to receive Section 609(g) assistance funds, the country directors stated they used a memo written by the MCC’s Chief of Staff as policy and guidance in making Section 609(g) decisions. This memo was not approved by the Chief Executive Officer of the MCC, nor did it provide adequate guidance in addressing bridge funding administration. Subsequently, the Chief of Staff stated that the memo was not an approved policy but a “concept paper” and should not be used as a policy.

The MCC is currently updating its Section 609(g) policy to address the issue of bridge funding for eligible countries; however, at the time of our fieldwork, the bridge funding policy had not been approved.

The lack of a formal Section 609(g) bridge funding policy occurred because the MCC, as a new organization, is still in the process of developing specific policies and procedures. The MCC has been in the process of reviewing and revising its Section 609(g) policy to address bridge funding and other evolutions in the use of 609(g) authority since it was originally issued. This issue was previously addressed in an earlier OIG report titled *Review of the Millennium Challenge Corporation’s Progress in Achieving its Planned Organizational Structure and Beginning its Assistance Programs* (Audit Report Number M-000-06-001-S). In response to one of the report recommendations to update the current Section 609(g) policy to address the issue of bridge funding, MCC management stated it “expects to complete a revision process by May 31, 2006.” However, at the time of our fieldwork, this revision process was yet to be completed. On July 26, 2006, the MCC provided a letter which summarized the status of corrective actions to OIG recommendations that required final actions. In the response, the MCC stated that it had drafted a revision to its 609(g) policy regarding bridge funding, which is currently under review by the Corporation’s top management. Therefore, because a previous recommendation was made on this subject, and the MCC has reportedly already taken corrective action, we are not making a recommendation in this report.

Did the Millennium Challenge Corporation Track and Monitor Section 609(g) Funds to Ensure Funds Were Used for the Intended Purposes Under the Millennium Challenge Act of 2003?

Overall, the Millennium Challenge Corporation has tracked and monitored Section 609(g) funds to ensure funds were used for the intended purposes under the Millennium Challenge Act of 2003. However, we noted several opportunities for overall improvement, specifically in the areas of financial controls, country procurement capacity assessment guidelines, and oversight of procurement activities and processes.

The following section discusses these issues in detail:

MCC Needs to Improve Monitoring of Section 609(g) Cash Advances

Summary: The Millennium Challenge Corporation (MCC) was not fully aware of how the Millennium Challenge Account (MCA) countries expended the total amount of its bridge funding, because the MCC did not require or provide an explanation to MCG requesting an expense or liquidation report documenting MCG's use of the Section 609(g) funding the MCC had committed to the country. An MCC official stated that the MCC did not request an expense report from MCG because it was not disbursing new funding but the remaining balance from previously approved funding. To ensure that organizations, such as the countries receiving Section 609(g) funds, do not mismanage the MCC funds, the *Treasury Financial Manual* (TFM) provides guidance that a funding Federal entity should follow when providing cash advances. The MCC did not request a report from MCA country that detailed how it spent the first cash advance of the bridge funding. The lack of proper monitoring of Section 609(g) cash advances to recipient countries increases the risk of a country using the funds inappropriately.

The MCC did not fully track and monitor the Section 609(g) funds it committed to one of its recipient countries and, as a result, it was not fully aware of how this country expended funds that it received from the MCC. In accordance with the MCA Act, the MCC assisted the Millennium Challenge Account Georgia (MCG) in preparing its Compact and covering administrative costs after it signed the Compact. The MCC committed a total of \$4,761,600 of Section 609(g) funding to the government of Georgia to assist with the preparation of its Compact and for covering administrative costs after it signed the Compact. The first funding, for pre-compact assistance, was in the amount of \$4,155,000, which was used to conduct feasibility studies and other projects that would support Georgia's proposal.

The second funding, \$606,600 (also termed bridge funding), assisted MCG with the purchase and procurement of office supplies and the payment of staff salary until the Compact entered-into-force.⁵ Although the MCC paid the contractors directly under the first Section 609(g) funding, it required MCG to submit disbursement requests for the second Section 609(g) funding, based on its cash needs; MCG submitted two disbursement requests, one on December 21, 2005, for \$543,459 and a second for \$63,141, on March 15, 2006. After receiving the first disbursement request, the MCC sent a cash advance in the requested amount to MCG on January 12, 2006, and sent the second payment on March 31, 2006. Several officials at the MCC who work closely with MCG later confirmed that MCG did not submit an expense report before receiving the second disbursement of \$63,141.

To explain the MCC's action, an MCC official stated that the MCC did not request an expense report from MCG because it was not disbursing new funding but the remaining balance from previously approved funding. He stated that MCG should provide the MCC with an expense report at the end of the Section 609(g) program, which should be in

⁵ Entry-into-Force is a term used to signify that the country has met all conditions precedent to the first disbursement made.

June 2006. Subsequent to the end of our review, the MCC received the expense report from MCG, which detailed how it spent the second Section 609(g) funding of \$606,600.

Although neither of the agreements that the MCC provided to the Millennium Challenge Georgia (MCG)— Grant or Implementation Agreement—required MCG to provide an expense report explaining its bridge-funded expenditures, the Implementation Agreement stated that MCG should, "at least monthly, reconcile actual cash payments it makes against the disbursements made by the MCC and shall provide such information to the Ministry and the MCC (if the MCC so requests)...," MCG submitted this information to the Ministry of Finance but not to the MCC, the entity providing the funding. In addition, the MCC did not make any such request until it had disbursed the total amount of the bridge funding—\$606,600.

To rectify similar issues, the *Treasury Financial Manual* (TFM) provides guidance that a funding Federal entity should follow when providing cash advances to recipient organizations. TFM Volume 1-Part 6, Section 2075.10a of the "Cash Advances Under Federal Grant and Other Programs" states that a federal agency should monitor "the recipient organization's drawdowns coupled with reviews of the other financial practices to ensure against excessive withdrawals of Federal funds."

Although the MCC disbursed a total of \$606,600 in bridge funding to the MCG, it did so without tracking the use of funds from the previous advance. In addition, the MCC approved the second disbursement request (\$63,142 of the total \$606,000) without verifying how MCG spent the initial cash advance. In the Implementation Agreement, a contract document between the MCC and the government of Georgia, the MCC did not require MCG to provide an expense or liquidation report documenting MCG's use of the \$606,000. However, as previously noted, an MCC official stated that MCG should provide the MCC with an expense report at the end of the Section 609(g) program, which should be in June 2006.

According to an MCC contractor, the MCC requested a certification from the Georgian Ministry of Finance, which should explain how MCG used the first disbursement of the bridge funding. The contractor stated that the certification should explain how these funds were used in accordance with the Implementation Agreement. However, neither MCG nor the contractor could confirm whether the Ministry of Finance submitted this information to the MCC. A representative from the Ministry of Finance also stated that her office was not aware of a liquidation report that they were required to submit to the MCC.

Though MCG used the funds for Section 609(g) activities, risks of improper expenditures may increase if a country does not report its expenses back to the MCC. An MCC official stated that it only requires the recipient organization to submit a report when requesting new funding or at the end of the program. As a result, the MCC may not know how the country spends the funds while the program is ongoing. In addition, not reviewing the country's expenses may result in the mismanagement of funds by countries with weak financial management systems. We are not making recommendation on this finding as the Office of Inspector General (OIG) has made similar recommendations in previous reports.⁶

⁶ *Risk Assessment of Millennium Challenge Account (MCA) Cape Verde* M-000-06-004-F dated September 26, 2006. Recommendation No.1 and *Audit of the Millennium Challenge Corporation Efforts to Establish its Internal Control Structure* M-000-05-002-P, dated March 31, 2005. Recommendation No.2

MCC Needs a Formal Policy to Approve Section 609(g) Contractors' Invoices

Summary: The Millennium Challenge Corporation (MCC) did not provide the National Business Center (NBC) with a list of officials designated to authorize payments of Section 609(g) contractors' invoices. The NBC could not confirm if the invoices it received were authorized by the appropriate designated official. This occurred because the MCC did not have a formal process in place to approve invoices of contractors who work in 609(g)-related countries where the MCC does not serve as the procurement agent. The General Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*⁷ recommends that in order to reduce fraud and error, agencies should develop key duties and responsibilities for authorizing transactions. As a result of not providing the NBC with a list of officials designated to authorize payments, the NBC could make payments to contractors who had not completed the assigned work as stated in the contract.

The National Business Center (NBC) is a U.S. agency that conducts financial functions related to paying contractors for the MCC. However, the NBC cannot ensure that contractors' invoices have been authorized for payment by designated MCA personnel. Currently, when the NBC receives invoices from countries receiving Section 609(g) funding, the MCA office certifies the invoices authorizing the NBC to pay the contractors. For example, the MCC committed \$4,155,000 of Section 609(g) funding to the government of Georgia for Millennium Challenge Account Georgia (MCG) for preparation of its Compact, which enabled MCG to conduct studies and surveys by contracting with contractors. In the Implementation Agreement, a contract document between the MCC and the recipient country, the MCC determined that MCG could serve as a procurement agent and select its own contractors. In addition, the MCC delegated its responsibility to approve or certify the contractors' work and required MCG to certify each contractor's invoice. After receiving the invoice, the MCC agreed to pay the contractors based on satisfactory certification by MCG.

The General Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* states, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them." In addition, GAO states that "transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. This is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events are initiated or entered into. Authorizations should be clearly communicated to managers and employees."

Although several officials at the MCC stated that the MCC was not authorized to approve the invoices, an NBC employee stated that she received the invoices from the MCC and not directly from Georgia. In addition, the NBC employee mentioned that she does not

⁷ *Standards for Internal Control in the Federal Government*. GAO/AIMD-00-21.3.1 November 1999.

know who MCG had designated to authorize the invoices. As a result, the NBC had received and paid at least 11 invoices that several individuals had authorized, including several invoices authorized by the CEO of MCG, and two individuals at the MCC who served as Contracting Officers Technical Representatives (COTR).

No one contacted at the MCC was able to clarify the proper process that the MCA or the MCC offices should follow when approving Section 609(g) contractors' invoices for payments. An MCC individual stated that there were mistakes with these invoices because the NBC did not know the process to follow when a Section 609(g) recipient country procures its contracts and the MCC pays the contractor. As a result, the NBC followed incorrect processes. For example, the NBC requested that COTRs approve the invoices even though the MCC did not designate its employees as COTRs for contractors working in Georgia for Section 609(g) activities. Therefore, the COTRs approved the payments of invoices for two contractors that they were not authorized to approve.

Due to the current invoice authorization process, the NBC does not know if the invoices are authorized by the appropriate personnel at the MCG. A person other than the designated official responsible for authorizing the invoices may sign the invoice without knowing if the contractor has completed the work. In addition, different individuals at the MCC review and approve invoices without knowing the regulations addressed in the Implementation Agreement that was signed by the MCC and the Section 609(g) recipient country. Approving invoices without confirmation that the contractor has completed the tasks which for which he was contracted could result in mismanagement of funds.

In order to improve the internal controls over the invoice approval process, and to reduce the potential for fraudulent invoices, we are making the following recommendation.

Recommendation No. 1: We recommend that the Millennium Challenge Corporation's Vice President for the Department of Operations provide the National Business Center with a list indicating all persons at Millennium Challenge Accounts who are designated to approve payments for invoices, in order to ensure validity of the contractors' work before making payments into their accounts.

MCC Needs to Improve Its Process For Approving and Documenting Exceptions to the Procurement Agreement

Summary: The Millennium Challenge Corporation (MCC) approved two Millennium Challenge-Georgia (MCG) contracts in excess of established limits. The files did not show that MCG created a justification for this exception. The General Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* recommends that in order to reduce fraud and error, agencies should develop key duties and responsibilities for authorizing transactions. The MCC policy did not require that MCG formally identify the exception in the Procurement Plan or provide a justification, or that the MCC formally waive its established cap. The method used for the procurement was not a full and open competition, although MCG contacted more suppliers than the minimum required, which could have led to a more costly procurement than necessary.

The General Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* recommends that in order to reduce fraud and error, agencies should develop key duties and responsibilities for authorizing transactions.

The MCC allowed MCG to procure goods in excess of the amount allowed by the Procurement Agreement. In particular, the Procurement Plan listed "Shopping" as the procurement method for MCG computer hardware at an estimated cost of \$67,920 and for a vehicle at an estimated cost of \$55,000 although procurements using this method were limited by the MCC in the Procurement Agreement to \$30,000. The Procurement Plan documents planned procurements, their estimated cost, and their method of procurement. MCG purchased these goods by shopping, which refers to a World Bank-defined method of purchasing goods by comparing price quotations from several suppliers. MCG explained that the MCC approved these procurements by its approval of the Procurement Plan (November 2005 to March 2006). At the time of our fieldwork, the files did not show that MCG created a justification for the exception and formally documented it in the Procurement Plan, nor that the MCC considered and formally waived the agreed-upon cap when approving the Procurement Plan. However, at the end of our fieldwork, we received several emails from the MCC's procurement specialist that documented the approvals and justifications for exceeding the \$30,000 limit as stated in the Procurement Plan.

The Procurement Agreement, dated April 7, 2005, permits the use of shopping for procurements valued at less than \$30,000. Shopping as defined by the World Bank Guidelines for *Procurement Under IBRD Loans and IDA Credits* is a procurement method based on comparing price quotations obtained from several suppliers, with a minimum of three, to ensure competitive prices, and is an appropriate method for procuring readily available off-the-shelf goods or standard specification commodities of small value. The MCC utilized portions of World Bank Guidelines in developing its own set of guidelines which specifically set a limit of \$30,000 for this procurement method.

World Bank Guidelines state that “open competition is the basis for efficient public procurement.” Shopping is not considered a full and open competition because it does not require, for instance, advertising, which would broadly disseminate the opportunity or other elements found in a competitive process. However, MCG did contact more suppliers than the minimum three required when conducting its procurement process. Nevertheless, the MCC established a limit of \$30,000 for a purpose—to encourage a fully open and competitive process and to control the use of this procurement method. However, the only support we found for diverting from the formal procurement agreement were personal statements and emails.

The Procurement Plan sets forth the particular contracts for goods, works, and/or services required to carry out the defined projects, the proposed methods of procurement that are permitted by agreement, and related review procedures. The MCC policy did not require that exceptions to the Procurement Agreement be identified and formally justified within the Procurement Plan and that the MCC formally waive its established expenditure limit of \$30,000. Electronic mail messages provided after our review showed that MCG had informed the MCC that one of the two procurements exceeded the shopping expenditure cap with MCG concluding that the method would be the most acceptable for the type of goods being purchased, i.e., a vehicle. Additionally, we found no formal MCC policy or guidance that describes the acceptable manner for reviewing deviations from the procurement agreement.

We believe that the MCC should have a formal policy which describes the methodology for authorizing deviations from the procurement agreement. Therefore, we are making the following recommendation.

Recommendation No. 2: We recommend that the Millennium Challenge Corporation’s Vice President, Department of Accountability, establish a policy that describes the process for approving deviations to the Procurement Agreement.

MCC Needs to Formally Develop Country Procurement Capacity Assessment Guidelines

Summary: The Millennium Challenge Corporation (MCC) had not formally developed its country procurement capacity assessment guidelines. Best practices from selected development agencies suggest the establishment of agency-specific guidelines or factors for assessing a grant recipient country’s capacity for procurements. The MCC did not formally develop guidelines because, as a new agency, it was still working on developing Agency-specific policies and procedures. The absence of formally developed guidelines has led to inconsistencies and nonstandardization in the process.

The MCC did not formally develop its country procurement capacity assessment⁸ guidelines or factors to ensure a consistent and standardized methodology for reviewing

⁸ MCC conducts assessments to determine if a recipient country has the ability to manage its own procurements.

a country's capacity to conduct procurements. The MCC assesses a country's procurement capability to determine if the country can manage its own procurements when it receives Section 609(g) or Compact assistance funds.

While the MCC's *Fiscal Accountability Framework*, implemented in May 2005, briefly describes procurement and contracting practices, it does not provide adequate guidance to personnel involved in conducting assessments of recipient countries' procurement capacity. The primary focus of the guidelines relates to fiscal accountability guidelines not procurement guidelines. For example, the MCC's procurement advisor stated that he uses the *Fiscal Accountability Framework* as a guide when he conducts country procurement capacity assessments. Another procurement specialist responsible for country procurement capacity assessment indicated that she uses an unofficial checklist that was self-created.

Selected international development organizations such as the World Bank and the International Development Association, ensure standardization and consistency in country procurement capacity assessments by establishing and documenting the procurement assessment factors that serve as guidelines for personnel assessing a recipient country's procurement. Although the MCC is clearly not subject to following these guidelines, it is instructive to note what types of factors or guidelines these older agencies have put in place to ensure standardization and consistency in their assessments of a country's procurement capacity assessments. These guidelines or factors include the following:

- Legal Framework
- Procurement System Organizational Framework
- Procurement Capacity building System/Institutions
- Procurement Procedures/Tools
- Decision making and Control Systems
- Anti corruption Initiatives and Programs
- Private Sector Participation in the System
- Contract Administration and Management
- System for Addressing Complaints

The lack of formally developed country procurement capacity assessment guidelines occurred because the MCC is a new organization and was still working on developing agency-specific policies and procedures.

Procurement is one of the highest risk areas of fiscal accountability; thus, the absence of formalized policies and guidelines could potentially result in several inconsistencies and nonstandardization in the process of assessing a country's capacity for procurements, thereby potentially increasing risks to the entire procurement process.

Therefore, in order to reduce inconsistencies and improve standardizing the procurement process, we are making the following recommendation.

Recommendation No. 3: We recommend that the Millennium Challenge Corporation's Vice President, Department of Accountability, to ensure consistency and standardization in the Millennium Challenge Corporation's due diligence process, formally develop and issue country procurement capacity assessment guidelines or procedures to use in determining a country's capacity, or in conducting procurement assessments.

MCC Needs to Improve Monitoring of Overseas Procurement Practices

Summary: The Millennium Challenge Corporation (MCC) did not provide adequate oversight of the Millennium Challenge Account-Lesotho (MCA-L) procurement practices resulting in delayed payments of over three-months to consultants. This condition occurred because the MCC did not have a policy to adequately address the issue of payments to independent consultants. The MCC modified World Bank guidelines that recommend adequate monitoring to ensure recipient country's compliance with procurement guidelines. The absence of adequate controls over the procurement process resulted in late payments to service providers.

World Bank Guidelines: Selection and Employment of Consultants by World Bank Borrowers May 2004, used by the MCC in developing their guidelines, was used to conduct and administer the procurements of these consulting services.

The MCC's guidelines require the MCC's review, assistance and monitoring in the procurement process. Paragraph 1.14 of the guidelines requires that, "the MCC review the Government of Lesotho's hiring of consultants to satisfy itself that the selection process is carried out in accordance with the provisions of these guidelines." Furthermore, Appendix 1 on page 45 states, "the MCC shall review the selection process for the hiring of the consultants proposed by Government of Lesotho...to ensure compliance with these guidelines."

The MCC did not provide adequate oversight of overseas procurement processes. During our field work in Lesotho to review and assess the status of Section 609(g) activities, several instances of inadequate controls over the procurement process were noted. For example, several individuals who served as independent evaluators on selection committees to select service providers for Section 609(g) contracts were unpaid for over three-months after their services had been provided and prior to the finalization of the contracts that established the payment rates.

These conditions occurred because the MCC did not have a policy to adequately address the issue of payments to independent consultants. Furthermore, the MCC management stated that the demand for payments for independent contractor services was new to them and occurred after the procurement process was underway. However, it is OIG's opinion that if the MCC had provided adequate oversight during the procurement process, then this issue may have been prevented.

An absence of adequate controls over the procurement process resulted in late payments to service providers and in contracts being finalized after services were rendered. Therefore, to improve the MCC's internal controls over service providers, we are making the following recommendation.

Recommendation No. 4: We recommend that the Vice President, Department of Accountability, strengthen controls over overseas procurements by developing and issuing clear and consistent procurement guidelines to recipient countries which would include a clear description of the Millennium Challenge Corporation's responsibilities for monitoring and reviewing the recipient country's procurements

EVALUATION OF MANAGEMENT COMMENTS

The MCC provided written comments to our draft report that are included in their entirety in Appendix II. In its response the MCC agreed with the four recommendations in the draft report.

For Recommendation No. 1, the MCC plans to provide the National Business Center (NBC) with a list indicating all persons at Millennium Challenge Accounts who are designated to authorize payments for invoices. In the event that a future 609(g) grant is implemented with the recipient country being granted procurement authority and the NBC serving as paying agent, the MCC will provide a list of those individuals in the recipient country organization authorized to approve invoices to the appropriate NBC personnel

For Recommendation No. 2, the MCC agreed that it should establish a more formalized record of specific grants of waivers, and has already instituted a specific format to record such waivers.

For Recommendation No. 3, the MCC stated that while conducting due diligence on the procurement systems of its partner countries, the MCC conducts a risk assessment, enabling it to hone in on the critical risk factors in the context of the environment that it finds in each country, thus concluding whether an independent procurement agent is needed. Further, the MCC stated that it has assembled a group of procurement professionals, each with decades of experience in a multitude of public sector settings, both domestic and international, to conduct assessments of procurement systems proposed by an MCC eligible country.

For Recommendation No. 4, the MCC, although agreeing with the recommendation, stated that the delay in payment resulted from the need to establish that the obligation had been properly incurred and authorized (effective internal controls), versus a lack of controls over procurement as noted in the finding. We agree with the MCC that establishing that an obligation and been properly incurred and authorized is an effective internal control process, however, the recommendation for monitoring and reviewing was based on independent contractors providing a service prior to having a contract in place, which described the scope of work and rate of pay. The MCC had a responsibility to review the selection process for the hiring of the contractors (MCC guidelines, Appendix 1), which in this case was not done, thus our recommendation related to monitoring and reviewing the recipient country's procurements. The MCC has controls in place to avoid this in the future, therefore we judge that MCC's response adequately addresses our concerns.

SCOPE AND METHODOLOGY

Scope

The Assistant Inspector General for the Millennium Challenge Corporation (AIG/MCC) audited the MCC's Section 609(g) Compact support activities in accordance with generally accepted government auditing standards. The audit scope was limited to reviewing the MCC's compliance with its internal program policies on Section 609(g) funding, relevant World Bank guidelines, and the Federal Acquisition Regulation. The scope also included the MCC's committed funding of \$43,061,263 to 11 countries for the period of March 2005 to July 2006.

Audit fieldwork was conducted at the MCC's headquarters offices in Washington, DC, between April 5, 2006, and July 14, 2006. Fieldwork also included site visits to Tbilisi, Republic of Georgia, between May 15, 2006 and May 19, 2006, and to Maseru, Kingdom of Lesotho, between May 23, 2006, and May 26, 2006.

Methodology

To gain an understanding of the Section 609(g) Compact support activities, we discussed the program with country directors who work with the countries that received the funding and with officials in the Department of Accountability, the Department of Operations and in the Department of Administration and Finance who were responsible for procurement and funds management. In addition, we performed the following steps:

- Reviewed relevant laws, regulations, and guidance to gain an understanding of Compact support funding requirements.
- Obtained a listing of countries that received Compact support funding and used this as a basis for conducting our work.
- Identified and judgmentally selected two countries for testing that used the Compact support funding to directly procure goods and services.
- Reviewed documentation related to procuring service providers, monitoring and evaluating their work, and paying for the services rendered.

MANAGEMENT COMMENTS



MEMORANDUM

September 7, 2006

TO: John Phee
Assistance Inspector General for the Millennium Challenge Corporation

FROM: Mike Casella
Deputy Vice President for Administration and Finance

SUBJECT: Management Response to IG Report on Management of Section 609(g)
Funds

The MCC appreciates the opportunity to respond to the text and recommendations of the report.

Recommendation No. 1: We recommend that the Vice President for the Department of Operations provide NBC with a list indicating all persons at Millennium Challenge Accounts who are designated to authorize payments for invoices, in order to ensure validity of the contractor's work before making payment into their accounts.

We concur with this recommendation that MCC provide NBC with a list indicating all persons at Millennium Challenge Accounts who are designated to authorize payments for invoices. In the event that a future 609(g) grant is implemented with the recipient country being granted procurement authority and NBC serving as paying agent, MCC will provide a list of those individuals in the recipient country organization authorized to approve invoices to the appropriate NBC personnel.

As the report notes, this particular issue arose in only one of the 17 Section 609(g) grants covered by the Report. In the case of the 609(g) grant to Georgia, approved on November 29, 2005, Georgia was granted authority to conduct its own procurements because it had secured an outside procurement agent but MCC did not grant Georgia authority to receive funds and make payments because Georgia did not yet have a fiscal agent in place. Accordingly, Millennium Challenge Account Georgia (MCG) used its

procurement agent to administer procurements, MCG staff signed contracts, and MCG staff were authorized to certify receipt of goods and services and the validity of invoices. However, MCC's financial service provider, the National Business Center (NBC), served as the paying agent for invoices once approved.

As the report further notes, it would have been inappropriate for any MCC employees to certify invoices submitted to MCG as MCC had no contractual or contract administration relationship to the vendors. It is accurate that the list of individuals authorized in MCG to approve invoices was not communicated to NBC at the outset of the grant implementation. However, there is no evidence that MCG approval of individual invoices were made by unauthorized individuals.

Recommendation No. 2: We recommend that the Vice President of Accountability establish a policy that describes the process of approving deviations to the Procurement Agreement.

We concur with this recommendation that MCC should establish a more formalized record of specific grants of waivers, and have already instituted a specific format to record such waivers.

The report describes two procurement actions that took place in relation to a 609(g) grant to the Government of Georgia that differed from the Procurement Guidelines that governed the grant. Procurement Guidelines are a framework to a process that supports the procurement goals of competition, transparency, fairness, and value. MCC believes that these underlying goals for conducting procurements should not be undercut by specific guidelines when the application of those guidelines would yield a result that undermines the goals. Consequently, we believe that application of the guidelines should also allow waiver of specific provisions when such a waiver is more consistent with the goals.

The report acknowledges there was indeed a record of communication establishing the reason for requesting a deviation, as well as the concurrence of our Senior Director for Procurement, and that this communication was conducted via e-mail but formalized only later in the context of approval of the Procurement Plan.

Recommendation No. 3: We recommend the Vice-President, Department of Accountability formally develop and issue country procurement capacity assessment guidelines or procedures for its personnel to use in determining a country's capacity for conducting procurement assessments to ensure consistency and standardization.

We concur with this recommendation that MCC should effectively communicate the requirements of an acceptable procurement system that meets international standards.

The international donor community has struggled for decades to create a set of standards to define an acceptable public procurement system and, as the report notes, some specific

donors have adopted factors of a good procurement system. However, effective and efficient public procurement is the result not only of rules but the application of those rules and, ultimately, whether the outcomes produced by a country's procurement process best serves the public interest. Because an acceptable public procurement process is of such a qualitative nature, the international donor community has never been able to reach consensus on either the specific factors of an acceptable system or the metrics that one would use to measure whether those factors are yielding the ultimate necessary outcomes.

In conducting due diligence on the procurement systems of our partner countries, MCC does not produce a detailed evaluation of the grantee's procurement system, a process which generally takes other donors at least two years to complete. Rather, we conduct a risk assessment. Thus, we need to be able to hone in on the critical risk factors in the context of the environment we find in each country. In some cases, our purpose can be fully served once we identify a single fatal flaw, leading us to conclude that an independent procurement agent is needed.

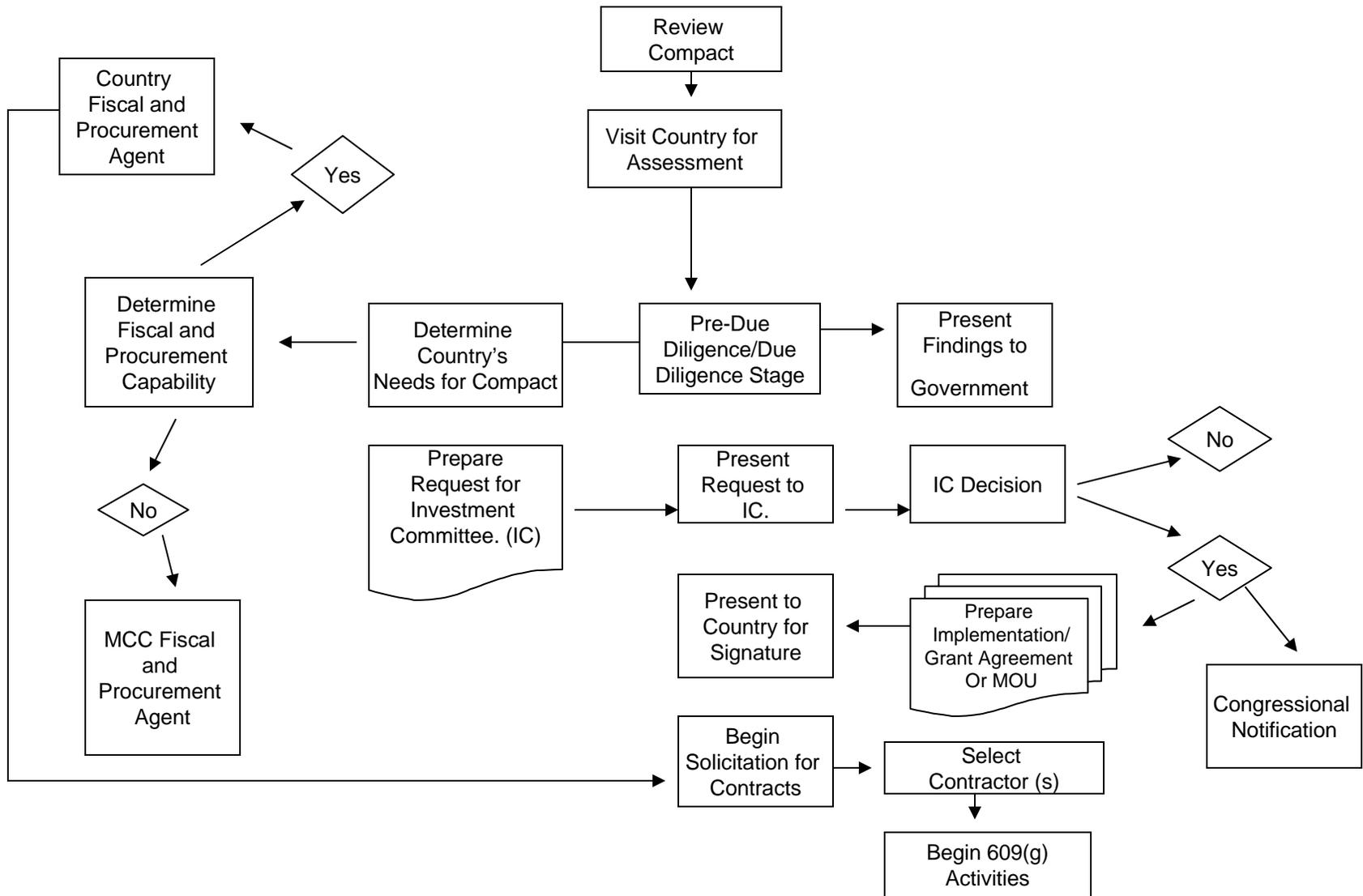
MCC has assembled a group of procurement professionals, each with decades of experience in a multitude of public sector settings, both domestic and international, to conduct assessments of procurement systems proposed by an MCC eligible country. The experience and knowledge they bring with them in conducting these assessments is invaluable in determining whether a proposed system, both in its framework and in its application, meets the requirements of transparency, fairness, competition, value, efficiency, and effectiveness.

Recommendation No. 4: We recommend that the Vice President, Department of Accountability strengthen controls over overseas procurements by developing and issuing clear and consistent guidelines to recipient countries which would include a clear description of MCC's responsibilities for monitoring and reviewing the recipient country's procurements.

We concur with this recommendation that MCC should provide clear guidance to recipient countries on the procurement requirements that govern MCC grants and the rights retained by MCC. Every Compact includes a specific agreement, labeled a Procurement Agreement, with very specific guidelines that must be followed for any procurement conducted to implement an MCC program. These guidelines include very specific rights of MCC to issue "no objections" at any number of stages in the procurement process for specific kinds of procurements, based either on the procurement's expected value or the nature of the contracting method being used. We believe the Procurement Agreements provide clear and consistent guidance on procurement requirements and on MCC's rights to oversee the procurements.

We also note that the text of the report preceding this recommendation discusses the delay in a payment to a service provider in Lesotho. In this case, the delay in payment resulted from the need to establish that the obligation had been properly incurred and authorized and the delay itself represents the impact of effective internal controls not, to the contrary, evidence of lack of controls over procurement.

Flowchart of 609(g) Process



U.S. Agency for International Development
Office of Inspector General
1300 Pennsylvania Ave, NW
Washington, DC 20523
Tel: (202) 712-1150
Fax: (202) 216-3047
www.usaid.gov/oig